RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

LETTER 871 **October 6, 1983**

THE MARKET: For months I have warned subscribers not to take this big bull market apart day by day, hour by hour, indicator by indicator. The broad overview is what counts in this kind of massive primary uptrend, and the broad overview is bullish.

I've said this before, and I'll repeat it: there is nothing more bullish than a situation wherein the Averages push to or above the primary highs—all against a background of increasing pessimism and disbelief. Why is this so? It's so because disbelief and pessimism indicate that the bull market has *not fully expressed itself.* It means that the bears are still bearish and fighting the primary trend. Ultimately, when the bull market is close to breathing its last, there won't be a bear around. All the pessimists will have thrown in the sponge. The sky will be pure blue with not a cloud in sight. That just isn't the case today.

Think of it. On September 20 the D-J Industrial Average recorded an all-time high of 1249.19. On the same day the D-J 65 Stock Average recorded an all-time high of 499.31. And on the same day the D-J Utility Average hit a high of 133.19, it's highest level since 1969. Only the Transports missed making a new high, and the miss was by less than a point.

Then two days later, on September 22, the NYSE announced that the total short interest had risen to a record 168.68 million, highest level in history (and 75% higher than August, 1982!). The short interest *ratio* also rose to 2.28, highest level since March of 1968.

What does this incredible short interest mean? It is telling us that bearishness is rampant and increasing—all in the face of a primary bull market that is at or near its record highs. It is telling us that there is massive DISBELIEF in the primary bull trend. When this occurs, the bull will push stocks higher and higher—until ultimately the last stubborn bear must either become a believer or go broke.

Remember, this isn't a day by day, hour by hour process. This is an extended, broad, overall process. The bull market can back and fill, spurt and sink, or even move sideways for months on end. But the thing I have been emphasizing to subscribers is that this is a great bull market, and it is still accompanied by extraordinary skepticism. Therefore, the longer the pessimism lasts and the longer the bull forces are held back, the greater the bullish potential and the higher this market is fated (ultimately) to climb.

Now this is interesting: recently the odd-lotters (and they are indicative of the general public) have stepped up their selling dramatically, and this too is a plus for the bull market. In due time, perhaps months or even a year or so from now, I expect the odd lotter to turn around and BUY this bull market (in direct opposition to their current selling proclivities).

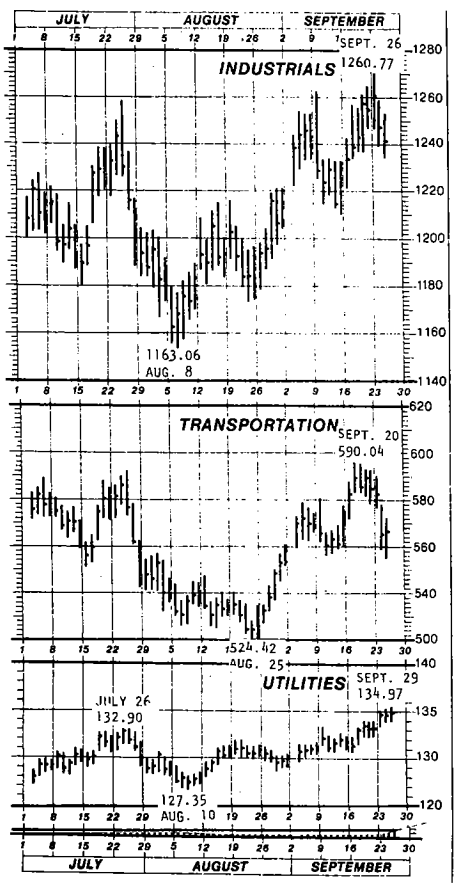
Sept. 23 DJIA 1255.59; PTI 1756; A-D Ratio -13.88
Sept. 30 DJIA 1233.13; PTI 1750; A-D Ratio -14.88

FRONT PAGE COMMENT: Remember my piece entitled "Crystal-balling it" in Letter 868? Well, I think that piece is on it's way to becoming reality. The commodity charts are telling me that inflation is about over. The grains are all cracking following their recent "weather bull market." Gold is weak, silver is quite weak. Heating oil is falling out of a head-and-shoulders top. Copper is coming unglued, platinum is sliding. The picture, to put it succinctly, is DEFLATIONARY.

In the face of the very weak commodity and metals picture, bonds are strong and interest rates are drifting lower. If gold cracks 400 (and I think it will) I expect the bond market to take off on the upside. This should prove to be a big plus for the stock market.

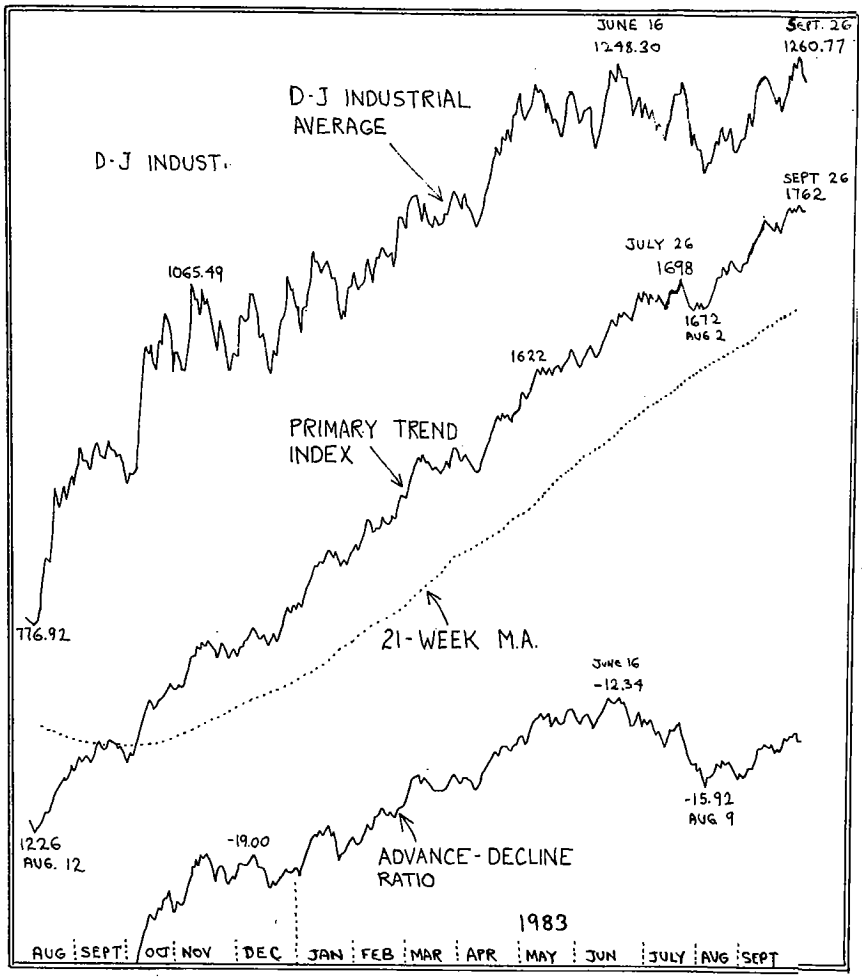
Question: Russell, you keep writing about and stressing that "the primary trend of the market is bullish." Why do you keep pushing this theme?

Answer: I stress the fact that this is a primary bull market because that is the single overriding market consideration at this time. For many months now the majority of analysts and investors have been totally obsessed with the idea that a "major correction" is upon us. In fact, I can't remember when I've read so many comments and warnings about the "coming correction."



The Averages and the A-D ratio peaked last June 16, and since then many of the highly speculative stocks have taken their beating while the blue-chips have been hit to a much lesser extent. Moreover, during most of the period since June 16 the Primary Trend Index (PTI) continued to push near the highs, and sporadically the PTI recorded new record highs.

During the same period the cumulative most-active stock index surged to new



bull market highs. On September 19 my on-balance-volume index for the entire NYSE also recorded a new high. All of this action only served to *reinforce* my belief that despite widespread bearishness, despite the three-month correction, despite warnings from well-known analysts, the direction of the primary trend is up; the bull is in command.

Of particular interest to me was the widely-advertised fact that "insiders" have been heavy sellers of stocks (in fact, insider selling during the period up to September was the heaviest in history): But I am reminded of the old stock market adage which states, "Enough inside information will break any man on Wall Street." And frankly, I have never been excited by the acumen of insiders–either regarding their own companies or regarding the market as a whole.

Whenever the market Averages fluctuate in an area below the primary peaks but above the last secondary lows (as we have been doing since last June) there is a certain sense of fear. People ask, "What's happening, could we be in a bear market?" The area below the primary peaks and above the last secondary lows is an area that I term "No-man's land," and it is always nerve-wracking to sit in no-man's land for months on end. As a rule, the LONGER the market fluctuates in no-man's land, the more apprehensive the analysts become, and the more fidgety stockholders become.

But I have always viewed the situation this way: in a primary bull market TIME WORKS FOR THE STOCKHOLDER, in a primary bear market TIME WORKS AGAINST THE STOCKHOLDER. A corollary of this is that values during a bull market *increase through time* even though the market may be moving sideways to down.

Consequently, during the period since the June 16 peaks, I have watched to see whether any real deterioration occurred. But when, in August and again in September, my indicators started breaking out to new record highs, I concluded that this was true bull market action (strength was increasing through time) and that the primary trend of the market remained strongly bullish regardless of any and all pessimistic opinions.

The fact is that three or four months AFTER THE TOP in a true primary bear market you are going to see deterioration, sliding indicators, collapsing stocks. You are NOT going to see items like new highs in the PTI, new highs in the cumulative most-active stocks index, new highs in the on-balance-volume index. And so I repeated over and over to my subscribers. "Sit tight, the bull lives, this is a primary bull market, and in due time the stock Averages and most individual issues will push to new highs."

Question: Russell, there are still a number of things that scare me out there in the real world. You may repeat that this is a bull market, but what if, say, the third world debt starts to crumble? Where is your primary bull market then?

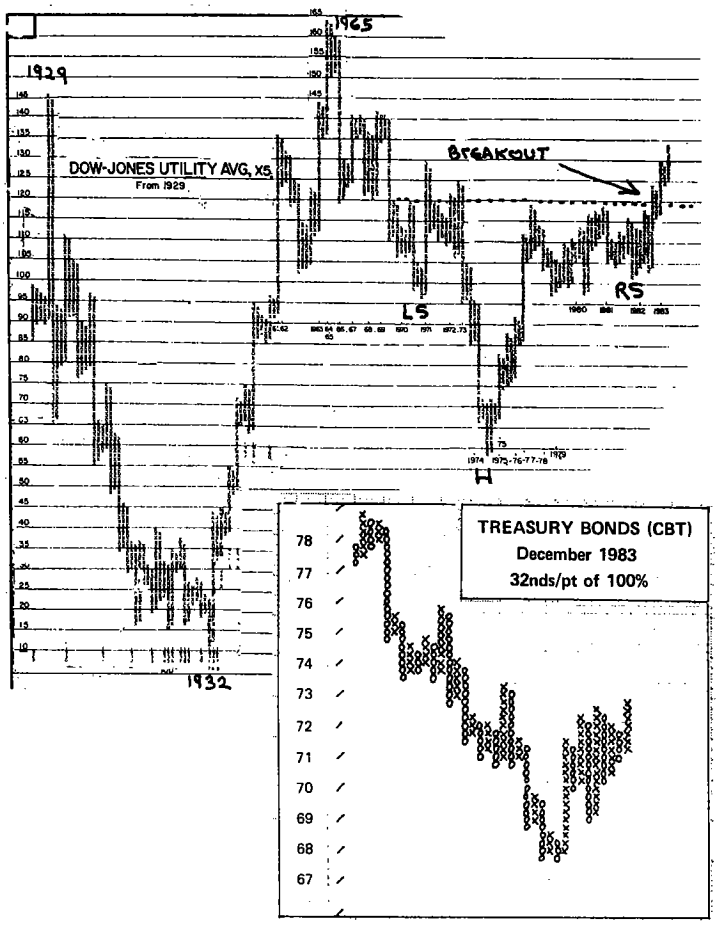
Answer: There's another old stock market adage which states, "Be concerned least with what the market fears most." Why? Simple, because what the market fears most is the item that has been *most fully discounted.* What does the market fear most today? I would say it is (1) an explosion in the money supply, (2) accelerating inflation, (3) a collapse of the foreign debts and therefore bank failures, (4) a major stock market top in this area. So you take it from there, I continue to believe we are in a primary bull market, and in a bull market "news goes WITH THE TREND."

Question: Russell, to get back to the short interest ratio, why is this indicator so important?

Answer: If short sellers are to make money, they need encouragement from the market ON THE DOWNSIDE. The real collapses, the ones where the shorts make big money, these collapses almost always bring in big volume. There is nothing more encouraging to a short seller, in fact, than a falling market accompanied by huge (liquidating-type) volume.

But when the market turns down and the volume dries up (as it has been doing during the June-September correction) this is very discouraging to the short sellers. When this occurs, the short interest to volume ratio shoots up, showing us that downside action is drying up as prices drift lower. Thus, the short interest ratio is a gauge of encouragement or discouragement for the short sellers. Right now, with the short interest ratio at a 25 year high, the shorts should be very discouraged. They simply cannot get this market going on the downside. And if it won't go down, by Gad, it's going to go UP!

UTILITIES, BONDS, INTEREST RATES: One of the items that I am watching is the tremendous base currently visible in the D-J Utility Average. A second item is the smaller but nevertheless very obvious base in the Treasury Bond Futures.



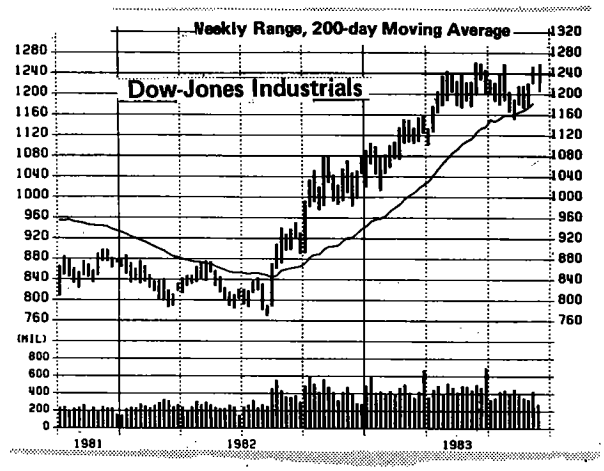
I have included these two charts here for you to study. The Utility chart goes all the way back to 1929. The T-Bond chart covers recent months.

The Utility Average was a bellwether all through the great bull market of the 1950s and '60s. And I expect it to be a bellwether again. At any rate, the Utilities have now rallied above major resistance in the 120-125 area, and the breakout is from a massive head-and-shoulders base. The projection or "count" from this base could easily take the Utilities to new historic highs.

The bond formation is also bullish, but of much smaller proportions. Nevertheless, these two charts taken together would seem to point to substantially lower interest rates in the period ahead. Both bonds and utilities are, of course, very sensitive to interest rates, and higher bond and utility prices are therefore a forecast of lower interest rates. (Utility chart courtesy of Market Charts, 20 Exchange Pl. NYC 10005. Bond chart courtesy of Dunn and Hargitt, 22 N. Second St., Lafayette, IN 47902).

KEEPING IT SIMPLE: In Letter 867 I used the Dow in relation to its 200-day moving average as a test of market strength. I noted that E. George Schaefer, the great Dow Theorist of the 1940s through the 1970s, consistently used the 200-day moving average as a guide to what the big investment money was doing. Schaefer called the 200-day MA the "investment line," and he was of the opinion that the Dow's position (above or below the 200-day MA) was most significant during a primary bull market.

As a rule, during a powerful bull market (such as this one) the Dow tends to move ABOVE this rising 200-day MA. Only during



the most drastic bull market corrections do we see the Dow drop temporarily below the 200-day MA.

Note on the accompanying chart that the Dow rallied above the 200-day MA during the first MONTH of the August, 1982 bottom. Since then the Dow has held above the rising 200-day MA on all rallies, declines and sideways movements. During August 1983, the Dow (for a single week) slid slightly below the 200-day MA, but it quickly advanced above the MA again.

I feel the Dow's performance in holding stubbornly above its 200-day MA ever since August, 1982, is a major element of strength in the picture. In other words, despite insider selling, despite great pessimism, despite many adverse new events and continuing high interest rates, investors continued to pay more for the Dow than they did on an average of the last 200 days. So it's a case of not listening to the talk but of *watching the action.* The action, gauged by the Dow in relation to its average price of the preceding 200 days, has been highly bullish ever since this advance began in August, 1982 (Dow chart courtesy of Holt Advisory, 290 Post St., Westport, CT 06880).

INVESTMENT POSITION: I've still got the bull in this box, and that means that the primary bull market (by my studies) is very much in force. Sit with your no-load funds and defense stocks. The market continues to absorb the corrective forces—brought on by the massive 50% momentum rise that was recorded in July, 1983. The absorption (corrective) process could last for weeks or even months longer. Long-term Treasury bonds could prove a very good and safe investment here, particularly if that shock of shock occurs and interest rates come down.

WHERE'S THE MONEY GOING? *The Consensus of Insiders* (PO Box 10247, Ft. Lauderdale, FL 33334) is one of the few publications that keeps careful track of where fund money goes. I thought these tabulations were particularly interesting, in view of what I've been saying about this primary bull market.

Here we see money flows since January, 1983. And note that since that date the traditional funds (stocks) have added stocks each month for a total addition (January to July) of $24 billion. During the same period the money market funds have lost money—to the tune of $33 billion.

So what we see here is money going out of money instruments and into stocks. And that's typical of action during a bull market.
(cont. on pg. 5)

DEFENSE SECTION

Most or all of the defense information (but not stock information) is based on an exclusive arrangement with **Mr. Melvyn Lippman of US Organization Chart Service**, La Jolla, California.

Question: Mel, you've talked to me about a whole "new US military." You've mentioned concepts that will turn everything we see today in the military into antiques. Would you elaborate, please?

Answer: We're moving into the area of what I term "the all new US military." The technology is emerging. To think it could not happen will prove to be a fatally dangerous notion.

The USSR in the immediate future will attempt to militarily break-away and thus force the United States to accept permanent military inferiority. America's very major hope in preventing this lies with its Research, Development, Test & Evaluation (RDT&E) programs. This fact, this hope, is receiving increasing recognition within the Department of Defense. In Fiscal year 1982 the defense budget provided $20 billion for RDT&E of which $13.6 billion was performed by private industry. Fiscal year 1983 RDT&E is estimated at $22.8 billion of which $15.8 billion will be performed by private industry. And for fiscal year 1984 it is estimated RDT&E will be $29.6 billion, an increase over the last two years exceeding 30%, and $21.9 billion will be performed by industry. This trend is in the initial phase and will continue for years to come.

One extremely important military research effort the United States is engaged in is the Directed Energy Program. This has many startling military capabilities; one is the High Energy Laser Program. A directed energy weapon is one that generates radiant energy or energetic particles, focuses them into narrow beams, and points and delivers them to targets. This energy may come from chemical fuel, electrical power, intense sources of heat or high explosives. The beams consist of charged or neutral atomic particles or electro-magnetic radiation and are capable of near-instantaneous delivery to targets. A directed energy weapon, in general, would consist of an energy source, a device such as a laser or particle accelerator, optical systems to direct and focus the beam, and the means to acquire, track and point at several targets in the span of seconds. These energy weapons have a wide array of applications and may be ground, sea, air, or space based. Directed energy weapons might be used as a stand-alone or as a part of a defense-in-depth concept. A single directed energy weapon could be designed with the capability of knocking out tens of targets in a relatively short period of time.

The potential contributions of directed energy weapons are significant. They would introduce new vulnerabilities to the USSR's arsenal of strategic weapons and therefor introduce new uncertainties in the Soviets' ability to achieve their objectives. They could (1) engage and defeat limited nuclear strikes by destroying Soviet ballistic missiles in the vulnerable boost phase, (2) provide us with many new response options, (3) selectively thin out attacking missiles and aircraft, and (4) aid United States strategic force retaliatory strikes by destroying a large portion of the USSR's air defenses. These are some of the attractive benefits for using directed energy weapons in the air, on land and the high seas.

Further, there are some obviously attractive benefits for using laser weapons in space. Outside the atmosphere the laser has the potential to transmit damaging energy at the speed of light over very long distances. Directed energy weapons could deny the use of space to the Soviet military while protecting America's space assets. Furthermore, lasers are not weapons of mass destruction. They direct energy to a prescribed target area and nowhere else.

The Space Laser Program is one of several directed energy research programs now underway by the Department of Defense. The technical maturity of these programs ranges from early in the proof-of concept phase to approaching the maturity necessary to enter the formal weapon development program. The Department of Defense intends to spend about $900 million by fiscal year 1988. A remarkable increase in this funding figure could occur. The 1984 defense budget as approved and signed by the President has authorized over $134 million for laser beam anti-missile systems technology alone!

Prime responsibility for this new technology lies with the Department of Defense's Defense Advanced Research Projects Agency, Lawrence Livermore and the Los Alamos National Laboratories. Private industry is joining in the partnership and will have an increasingly larger role in its research and development. As in most development programs, the present focus is on two basic issues–are such weapons feasible, and, if they are, at what cost? The efforts to resolve these issues are extensive because (unlike familiar weapon forms such as guns and aircraft) the United States for the first time is addressing brand new weapon forms that have never been developed and deployed before.

Directed energy weapons will make a very major contribution to the US's defense posture. This new technology, in addition to other research programs, has the potential of providing America with a giant leap forward into completely new defense weapon systems that will give the US the capability of partially closing the widening military weapons gap which presently favors the USSR.

Research, development, hi-technology, advanced technology; these have always been part of America's strengths and they have always guaranteed her tomorrows. There are reasons to think (to hope) this may continue to be. It requires the spending of a great deal of America's time, treasure and talent. But there are no guarantees; there never have been.

Question: Russell, you so often write about no-load mutual funds as the way to go in a bull market. Are there any defense funds?

Answer: As far as I know, there are not. The nearest thing to a defense fund could be Fidelity's Select–Technology Portfolio which specializes in hi-tech and science stocks, and as you know–the "new military" will be a very hi-tech, science-oriented organization. In fact, if a war is eventually fought between hi-tech military organizations, it is probable that neither side will actually see their enemy. The attacks will literally come "from nowhere." (Fidelity, 1-800/225-6190).

Question: Why have you chosen Lippman to write the Defense Section?

Answer: For almost a quarter of a century Lippman has been providing intelligence and information about the corporate and military. He is president and publisher of US Organization Chart Service out of La Jolla, and the organization is a leader in its field. Lippman is impartial, and has no ax to grind. His business is information, and that is exactly what he is supplying to readers of these reports.

Interestingly, new money keeps pouring into the mutual funds, and thus, despite their steady purchasing of common stocks, their cash reserves remain healthy.

MONTH	TRADITIONAL MUTUAL FUNDS (millions)		MONEY MARKET FUNDS (millions)	
January 1983	1,096.2	80,383.7	- 8,987.4	197,620.1
February	1,293.9	84,981.3	- 8,200.7	189,419.4
March	2,237.6	90,075.0	- 9,108.8	180,310.6
April	2,893.8	98,668.6	- 8,808.8	171,501.8
May	2,508.8	101,422.5	- 1,850.9	169,650.9
June	2,192.6[r]	106,448.8[r]	- 5,020.3	164,630.6
July	2,140.4	104,287.3	- 223.7	164,406.9

NOTES & QUOTES: From our Quotes Worth Quoting Dept:

"So far, the Fed has not eased aggressively, but they now have the *potential* to do so. With the Economy cooling slightly, inflation under fairly good control with the inflation hedge metals under downside pressure, with severe international debt problems, and export problems for the US due partly to a strong Dollar (the US Dollar is up 46% on a trade-weighted basis since 1980), it is hard to believe that the Fed will not resume a mildly accommodative posture soon."

From Ned David Research (1-800/241-0621)

"By no stretch of the imagination can recent commodity price action be considered inflationary. Indeed, the recent months' upburst in commodities has been almost exclusively generated by the grain protein complex. These rallies in "protein gold" were triggered fundamentally by the ill-timed government PIK program and this summer's drought. Now, however, even the grain complex has rolled over to the downside, joining the metal, food and fiber and meat markets, which are in trading ranges.

"Weather bull markets, such as we witnessed in the grains the past couple of months, technically are not inflationary. They are, instead, the result of a natural phenomenon-drought. Inflation is manmade, resulting ultimately from an increase in the supply of money."

From The Reaper, PO Box 39026, Phoenix, AZ 85069

* *

I have received many letters about the new Defense Section, most of them very encouraging but a few of them depreciatory. One thing I did learn, however, and that is that very, very few of my subscribers (or anyone else, for that matter) know a damn thing about the military, the Russian capabilities, our capabilities, or what the whole picture is all about.

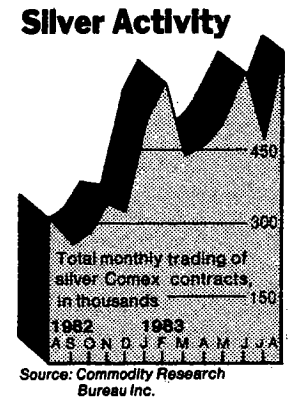
What I am doing here is offering information, real, down-to-earth, hard-to-find information. You may feel that we should disarm and give in to the Russians ("Let them run the world"), you may feel that we are equal militarily to the Russians, you may wonder where the devil we are in relation to the Russians. But the chances are that you, like me, need information. The existence of a Democracy is totally dependent on an informed electorate. And I'll swear by any reputation I may have, that 98% of the American people don't have the vaguest idea of what our military or the Russian military is all about. But that knowledge may be the difference, ultimately, in life or death in the US—or freedom or slavery. I firmly believe this.

* *

If you like action and excitement silver is where it's happening. Trading in silver set a record (for the first 8 months of 1983) on the New York Commodity Exchange. On a good day last year silver contract volume ran to around 4,000 contracts. A slow day today yields about 15,000 contracts. Now whether you will make any money in silver—that's a different story. But the interest is there—as judged by volume (see gold section at end of Letter).

* *

A local San Diego broker sold some San Diego Gas and Electric stock to a widow. "It won't make you rich," he cautioned, "but it will take care of your gas and electric bills." A couple of months later the widow called. "It didn't work," she complained, "They're still sending me a bill each month!"



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An article by Yossef Bodansky in the Sept. 19 issue of Business Week offers (to my mind) the most logical reason for the Russian attack on the S. Korean airliner. The Russians, says Bodansky, are paranoid about penetration of their air space over the Kamchatka Peninsula. The reason is that there is a giant Russian military build-up going on in Kamchatka, one that violates the Salt 1 agreement. On Kamchatka there is a vast increase in mobile missiles—ss-20s and ss-16s. The Soviets are also testing a new generation of ballistic missiles and aerospace defense missiles on Kamchatka. The Korean jet penetrated this top secret Soviet space by night and by surprise and by Soviet criteria it had to be destroyed.

* *

I've read a lot of personal ads in my lifetime, but the ones now appearing in New York magazine are in a class by themselves. I mean, these people don't fool around—they state their wants and their wares. Included below are a few examples, all from the

September 19 issue of New York. I asked one of my pretty California secretaries what she thought of them. "They're specific, all right," she said, " and definitely intimidating."

Semi-Retired, 40—6'1", bearded, I live on a mountain in NJ. I seek a beautiful, dazzling girlfriend, 21-31, to help me enjoy the great life and co-pilot my '83 Benz 380 SL. Phone/photo. NYM Box 761.

If You're A Park Ave.—And 57 St. Lady, I'd like to have an afternoon relationship with you at your apartment. I'm a married corporate executive, mid 30s, 6'2", 170 lbs. Send name and phone. NYM Box 743.

Wanted Millionaire—Attractive, aggressive, unusual virile male, 40-55, with time to enjoy life. Chic, worldly, sensuous, brilliant, beautiful, successful

Love Dancing?—My interests and areas of expertise are varied. Two of my favorite pastimes definitely require a male partner. One of them is dancing. If you are an excellent dancer let's find out how else we match. I'm a divorced white female, 5'2", 108 lbs., 50. Please include phone. P.O. Box 3245, S. Farmingdale, NY 11735.

Lady Tennis Pro—Or 'a" player wanted, to improve my tennis and maybe travel with me. I am a good-looking single Jewish male, 49, president of successful international business. NYM Box 642.

LATE NOTE: Electronic Associates reported a large loss for the third quarter with probable further smaller losses in the fourth quarter. While longer-term prospects for defense contracts appear bright, I would nevertheless advise people who cannot wait for long-term potential to lighten up at this time. Stock will remain on the supervised list as a long-term hold.

Below is a late rundown of our defense stock portfolio (stock are adjusted for splits and stock dividends).

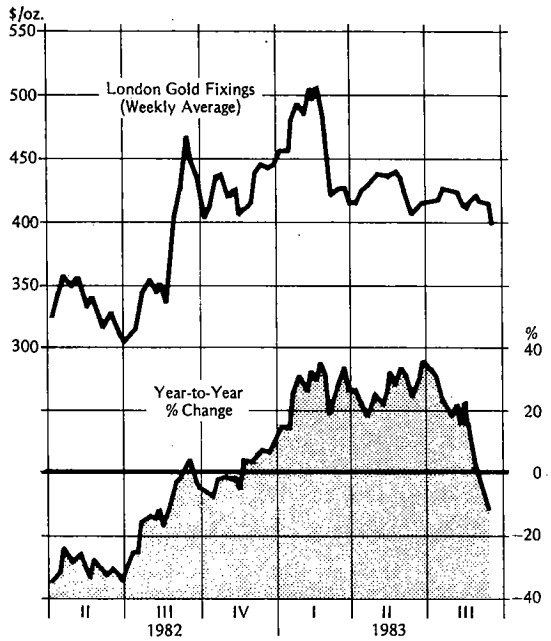
		Our Buy Price	Current Price	
NYSE	Harris Corp. (HRS)	49½	37¼	Defense stock average based on 1 share of each this week is 365 3/4
NYSE	LFE (LFE)	11 7/8	13 1/8	
NYSE	Planning Research (PLN)	14 3/8	15 1/2	
NYSE	Scientific Atlantic (SFA)	19	16 1/8	
NYSE	Tracor (TRR) (2 5 % stock)	28 3/4	32 1/8	
NYSE	Electronic Assoc. (EA)	13	12 5/8	
NYSE	Varo (VRO)	19	18 3/8	
NYSE	Bolt Beranek (BBN) (50% stock)	37	84	
NYSE	BDM (BDM)	43½	86¼	
AMEX	Dynalectron (DYN)	12 3/4	14	% Increase is: 32%
AMEX	Moog B (MOGB)	15½	17 3/4	
AMEX	Systems Planning (SPZ)	7	9 3/8	
AMEX	American Science (ASE)	10½	9¼	
	Original purchase price	278		

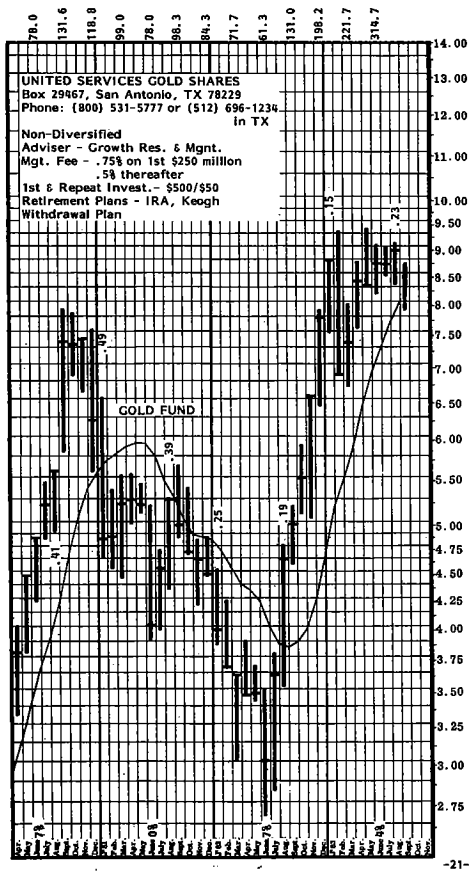
GOLD: I have, for years, kept a chart showing gold as a ratio of its price 13 weeks ago. I have called this a momentum chart. Many analysts keep momentum charts, often of varying periods such as a three month or a six month ratio—or even longer.

Tom Holt of *Holt Advisory* follows a chart of the year to year change in gold, and I feel that this study is particularly interesting at this time. It's interesting because for the first time since the second quarter of 1982 gold momentum has fallen below zero (on a year to year comparison basis). This is a significant and technically bearish situation. It's bearish because it means that anyone who owned gold as long as a year ago (in September-October, 1982) is (1) now losing money on the actual price of gold, and (2) is losing money in terms of interest lost through holding gold instead of say Treasury bills.

So far, the gold stocks have totally ignored the weakness in the gold price. But on September 29, following an extended sideways movement, the gold shares were hit hard. On that same day United Services Gold Shares (a no-load gold fund) broke below its MA since August, 1982—at which time the fund pushed above its 10-month MA. Thus, the gold shares have not given a bear signal, one which I do not believe will be quickly reversed. (Chart of United Services Gold courtesy of Growth Fund Guide, Box 6600, Rapid City, SD 57709).

For many months analysts have been arguing about whether the strength in the gold shares were a prediction of higher bullion prices—or whether the sluggishness in bullion was a forecast of lower share prices. I opted for the second situation, and that is what appears to be occurring.





NEXT MAILING: Oct. 19